

# Chinese Aided Special Economic Zones as a Means for North Korean Reform

Research Thesis

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## Abstract

The purpose of this thesis is to provide an introduction and analysis of the special economic zones (SEZ) that are being established in the Democratic People's Republic of Korea (North Korea or the DPRK) in conjunction with the People's Republic of China (China or the PRC) and to determine whether these SEZs will result in an "opening up"<sup>1</sup> of North Korea. Beijing, known historically for its pragmatic economic policies, typically invests into regions that it believes can increase the amount of foreign direct investments (FDI) by corporations and other nations. However, in the case of the special economic zones in North Korea, China is attempting to do far more than what their South Korean (Republic of Korea or ROK) counterparts are doing with the Kaesong Industrial Complex (KIC), which is to capitalize on the low labor costs in North Korea and encourage economic reform.<sup>2</sup> In comparison to the KIC, which almost entirely focuses on manufacturing, Beijing seeks to create a zone that would allow exports, imports, manufacturing, financial services, and tourism. This is part of China's overall Changchun-Jilin-Tumen (Changjitu) Plan, which focuses on boosting the economy of Jilin, a province that has lagged behind China's rapid coastal development. Chinese investors believe that the geostrategic location of the Rason Special Economic Zone can help the Changjitu Project achieve a 19% growth rate and create an output of over \$200 billion by 2020.<sup>3</sup> The plan would also mean that Rason would become a transportation hub for the countries in North East Asia, including landlocked Mongolia, Russia, Japan, and South Korea.

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<sup>1</sup> "Opening Up" is a reference to China's "改革开放", or Gaegekaefang, which was what China called its economic reforms in the late 70's and early 80's (Grasso 2009).

<sup>2</sup> In an interview with David Kang conducted by the Council on Foreign Relations (CFR), Professor Kang elaborates on the potential of investing in North Korea through SEZs. For a more detailed explanation of these benefits, refer to Teslik In sources cited.

<sup>3</sup> Lee, Yeon, and Jeong Kang. "The Changjitu Project and China-North Korean Economic Cooperation." *BISA Annual Conference*, 2011.

However, North Korea is not China. Therefore, the SEZ models that China experimented with during its opening-up era cannot be used as a panacea for North Korean economic failure. Whether an SEZ is supported by China or South Korea, it will always be limited by the North Korean regime. Armed guards, internet restriction, a lack of economic understanding, and threats of nuclear attacks by North Korea prohibit these zones from becoming industrious regions that could help stabilize the country. As a result, even Chinese aided SEZs will follow a historic trend of stagnating or failing unless North Korea makes significant changes in its economic and foreign policy.

### **1.1 A Tumultuous History**

Considering how the history of the Korean Peninsula extends over 3,000 years, this paper paper's introduction of North Korea will focus on the history beginning in the 19<sup>th</sup> century, specifically on the creation of the two Koreas. The divisive history of the Korean peninsula began following the exit of Japanese occupation after World War II where a proposal between the United States and the Soviet Union split the country along the 38<sup>th</sup> parallel in order to establish a provisional government on the peninsula.<sup>4</sup> However, discrepancies between the acting parties resulted in a failure to provide general and free elections, resulting in a Soviet supported North and a United States backed South.

With tensions rising due to cross-border skirmishes, the Korean War broke out when the North Korean People's Army (KPA) invaded its southern counterpart on June 25, 1950 in response to an alleged South Korean raid. At the time, Kim Il-sung, father and predecessor to

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<sup>4</sup> Halsall, Paul. *Modern History Sourcebook: Report of The United Nations Commission on Korea, 1950*. July 1998. <http://www.fordham.edu/halsall/mod/1950-korea-un1.html> (accessed February 10, 2012).

Kim Jong-il, had enough political backing and national interest for the attack. Kim Il-sung had confirmed with Mao Zedong that China was in support of a unified peninsula, albeit Mao's support was described as "loose" and was really expressed to show faith in Russia's expanding communist influence.<sup>5</sup> With the newly formed Peoples Republic of China (PRC) sponsoring his decision and a nationalistic motivation to reunite the peninsula, Kim Il-sung's confidence proved to be a miscalculation for his country when the Korean War resulted in a cease-fire, called the Korean Armistice Agreement, and is now referred to as a proxy war between the United States and the Soviet Union.<sup>6</sup>

The signing of the Armistice on July 27, 1953 resulted in what is now called the Korean Demilitarized Zone (DMZ), a 250 kilometer long border that separates the two countries. From the end of the Korean War to Kim Jong-il's ascension to leadership, relations remained tense until the South declared its "Sunshine Policy" in 2000 which promised further cooperation and peace between the two countries.<sup>7</sup> For the North, the Korean War had a devastating effect on the infrastructure of North Korea. Without U.S. financial assistance, the country relied on China and the Soviet Union for reconstruction funds. While rebuilding the country during the first few years after the war, Kim Il-sung consolidated power by developing a strong cult of personality. His status, at least in North Korea, was considered as high as Mao, Marx, Lenin, and Stalin.<sup>8</sup>

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<sup>5</sup> Wingrove, Paul. "Who Started Korea." *History Today*. July 2000. <http://www.historytoday.com/paul-wingrove/who-started-korea>.

<sup>6</sup> Center of Military History. *www.history.army.mil*. July 10, 2006. <http://www.history.army.mil/books/AMH-V2/AMH%20V2/chapter8.htm>.

<sup>7</sup> The Sunshine Policy played an important role in the creation of two major SEZs, Mount Kumgang Tourist Region and the Sinuiju Special Administrative Region.

<sup>8</sup> This status is only upheld among the North Korea people. In many countries, particularly Western ones, The Kim Regime and Kim Il-sung is often seen in a significantly more negative light. See BBC News. "North Korea Profile." *www.bbc.co.uk*. <http://news.bbc.co.uk/2/shared/spl/hi/guides/456900/456994/html/nn2page1.stm>, 2013 for a more detailed explanation.

Although not entirely allies with its two neighboring communist countries, North Korea was able to maintain relatively good relations throughout its developing years. The country began to focus on protecting its regime despite severe economic slowdown by funneling billions into its nuclear program. North Korea's Juche Ideology, just as controversial as its human rights record and failed economic policy, required the country to be self-sustainable thus further isolating the country. As the nuclear program continued to develop, it began to bankrupt the government resulting in North Korea falling farther behind the rest of Asia economically and politically.

During President Bush's 2002 State of the Union, North Korea was referred to as a member of the "Axis of Evil". Following the discovery of Pyongyang's uranium enrichment facilities, North Korea withdrew from the Non-proliferation Treaty the following year. Under North Korea's Songun Politics, it is believed that establishing a nuclear program is a means to become both politically and economically independent.<sup>9</sup> Since 1988 though, North Korea has also been slowly implementing reforms in the economic system as well. In 1991, North Korea first established the Rajin-Sonbong Special Economic Zone (later to be named Rason) for the purpose of export processing and transportation.<sup>10</sup> To North Korea watchers and other experts, the Rajin-Sonbong Special Economic Zone was a sign that if Six Party talks continued to fail, North Korea was still going in the right direction in the sense that economic reform could result in political reform.<sup>11</sup>

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<sup>9</sup> Chipman, John. *North Korean Security Challenges*. London: The International Institute for Strategic Studies, 2011., 10-12

<sup>10</sup> Abraham, Andray. *A Convergence of Interest: Prospects for the Rason Special Economic Zone*. Washington, D.C.: Korean Economic Institute, 2012.

<sup>11</sup> Ibid, 1-2

Fortunately, at the time the Rajin-Sonbong Special Economic Zone was not the only area being developed. Momentum from the Sunshine Policies improved South Korean and North Korean relations to the point where, in 1998, the two countries collaborated on developing a joint zone that could serve the interest of both countries. Titled the Kaesong Industrial Complex, it was a region located near the DMZ that acted as an industrial park for South Korean businesses to manufacture goods using North Korean cheap labor. This marked an improvement in Korean relations, but did not hinder North Korea's nuclear weapon development. Additional attempts came in the form of the Mount Kumgang Tourist Region and the Sinuiju Special Administrative Region.<sup>12</sup>

Although this paper is about the role of SEZ, it is important to recognize the enormous effect the nuclear situation has on negotiations with North Korea. The biggest mistake in talking with North Korea is that negotiators often do not recognize the importance of separating the nuclear issue from other issues, such as those involving human rights or economics. Negotiations like the 2007 Six-Party Talks were considered relatively successful when North Korea agreed to disable all of its nuclear facilities in exchange for fuel and other goods. These Six-Party Talks were a U.S led initiative to de-nuclearize North Korea and further promote peace on the peninsula.<sup>13</sup> However, in June of 2009 the United Nations Security Council (UNSC) responded to a North Korean satellite launch and an underground nuclear detonation by adopting Resolution 1874, preventing the “provision of nuclear technology, large scale weapons, luxury goods, and permits required cargo inspections of North Korean shipping vessels.”<sup>14</sup> The 2009 sanction was the second sanction to be placed on North Korea since its 2006 nuclear test, an act

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<sup>12</sup> These special specific zones will be discussed more in depth later on in this paper.

<sup>13</sup> Ibid, 81-85

<sup>14</sup> United Nations. *United Nations Security Council SC/9679*. June 12, 2009.  
<http://www.un.org/News/Press/docs/2009/sc9679.doc.htm>.

condemned by almost the entire international community and led to UNSC Resolution 1718. Relations were once again strained when a naval skirmish took place over a disputed maritime boundary between North and South Korea in November of 2009.<sup>15</sup> However, the situation seemed to have little effect on U.S.-North Korean relations when special representative Stephen Bosworth was able to visit Pyongyang for the first senior-level meeting with the new administration the following month.

The year 2010 proved to be a tense time for negotiations due to a torpedo incident that almost brought war to the Korean peninsula. North Korea's alleged torpedo strike on the Cheonan and the shelling of Yeonpyeong Island resulted in South Korea formally accusing the North for its attack and severing "almost all trade" with Pyongyang.<sup>16</sup> As South Korea and the United States conducted joint military exercises, North Korea threatened to turn Seoul into a "Sea of Fire".<sup>17</sup> Throughout this period though, Kim Jong-il made several health trips to Beijing, making analysts wonder whether North Korea had the technology to address his ailing health.

History has shown that North Korean negotiations tend to fall apart if they believe their nuclear program is at risk. Thus, China has taken a unique perspective when engaging with North Korea. Instead of directly addressing the elephant in the room, China has decided to work with North Korea on other issues in order to build trust and cooperation. Since Kim Jong-il's death in December of 2011, relations were reignited in the form of nuclear talks with North

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<sup>15</sup> Chipman, John. *North Korean Security Challenges*. London: The International Institute for Strategic Studies, 2011. 90-91

<sup>16</sup> Arms Control Association Timeline. *Chronology of U.S.-North Korean Nuclear and Missile Diplomacy*. September 24, 2011. <http://www.armscontrol.org/factsheets/dprkchron>.

<sup>17</sup> Moran, Lee. *North Korea threatens to turn Seoul's palace into 'sea of fire' after South conducts military drills on front-line*. November 24, 2011. <http://www.dailymail.co.uk/news/article-2065680/North-Korea-threatens-turn-Seouls-palace-sea-South-conducts-military-drills-line.html>.



Korea on February 23, 2013 in Beijing. However, nukes were just a minor subject of the talks that encouraged increased trade, communication, and upholding socialist values. That year, Kim Jong-un also began showing signs of consolidating his power as the rubber stamp general assembly elected him to become the First Secretary of the Workers Party (the ruling political party of North Korea), the removal of General Ri Yong-ho who was believed to be a threat to Kim Jong-un, and a rocket test in April that marked the birthday of Kim Il-sung. As of 2013, North Korea carried out its third nuclear test that drew condemnation from around the world including its closest ally, China. The February 2013 nuclear test resulted in China's Foreign Minister Yang Jiechi saying that China was "strongly dissatisfied and resolutely opposed" to the test, urging North Korea to "stop any rhetoric that could worsen the situation."<sup>18</sup>

### **1.2 Chinese-North Korean Relations**

Historically, China has had more influence on Korean society than any other country. From the time of the first Chinese emperor when Korea was a tributary state to the current situation where China represents North Korea's largest trade partner, their relationship is critical to the sustainability of the regime. During a banquet held for a visit from Kim Jong-un, former President Hu Jintao summarized Sino-North Korean relations as such.

The Chinese party and government have consistently maintained and propelled the Sino-DPRK friendship and cooperation in a farsighted way and on a strategic level. It is our unshakable policy to consolidate and develop the traditional friendship.

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<sup>18</sup> FloCruz, Michelle. *China Resolutely Opposed to North Korea's Third Nuclear Test*. February 12, 2013. <http://www.ibtimes.com/china-resolutely-opposed-north-koreas-third-nuclear-test-1078730>.

We, together with the Korean comrades, will steadily develop the bilateral friendship and cooperation in the spirit of inheriting tradition, facing up to the future, building good neighborly friendship and strengthening cooperation. In this way, we will work hard to accelerate socialist construction in the two countries, promote interests common to the two sides and defend and promote the peace, stability, and prosperity of the region.<sup>19</sup>

This paper will recognize the importance of China's historical involvement with North Korea but will primarily focus on China's economic interests in North Korea, beginning with a basic explanation of relations between the two countries. In as simple terms as possible, China's North Korea policy typically consist of the "Three No's." No war, no chaos, and no nukes. Hyun-Wook Kim, a professor at the Korea National Diplomatic Academy, justifies "no nukes" as being last because China knows that ending North Korea's nuclear program is a long term goal, rather than a short term one.<sup>20</sup> When China's condemnation of the 2006 Nuclear Test fell on deaf ears, China divided its North Korea policy to address the country itself and then the nuclear issue. The proposed special economic zones, primarily backed by China, are part of a larger plan to make the most of a poor situation. Rather than provoke a response that could result in another nuclear test, China would rather focus on a policy that would emphasize economic development.

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<sup>19</sup> Hu, Jintao. "Speech during Banquet Honoring Kim Jong-il." <http://www.kcna.co.jp/item/2011/201105/news27/20110527-32ee.html>, Beijing, 2011.

<sup>20</sup> Kim, Hyun-Wook. *Rowing Together: A Korean Perspective on U.S.-China-ROK Trilateral Coordination on the Korean Peninsula*. Beijing: Institute of Foreign Affairs and National Security, 2010.

At the forefront of negotiations with North Korea are the so called “Six-Party Talks” that include South Korea, North Korea, China, United States, Russia, and Japan. China has consistently promoted these talks with the hope that eventually North Korea will give up its nuclear program for economic aid. However, the scope of the Six Party Talks are often criticized for being too narrow. Some experts have suggested special economic zones as an “alternative to Six Party Talks”<sup>21</sup> with China spearheading the movement. The other issue is ensuring North Korea’s stability. China recognizes that a failed state would result in millions of refugees crossing the border which would ruin any plans of Chinese aided SEZs in North Korea and leave China with a massive humanitarian crisis on their hands. In order to promote stability, China has been improving its economic relationship with the D.P.R.K. over the last ten years. The Korea Trade-Investment Promotion Agency estimates that trade with China represented 79% <sup>22</sup> of North Korea’s total trade volume. Furthermore, from 2005-2010, China-North Korean trade grew six fold from less than \$500 million to a record high of \$3.4 billion.<sup>23</sup>

The question arises as to what exactly is China receiving from all the trade occurring between the two countries? Bates Gill wrote in his most recent dossier on China’s North Korea policy that the “major investments appear to have primarily targeted the mining and minerals sector.” These investments are expected to increase significantly, such as the Chinese firm Shangdi Guangquan Investment’s plan to invest \$2 billion in the Rason free trade area to build

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<sup>21</sup> Agacevic, Andrej. *D.P.R. of Korea security issue: P.R. of China's model of Special Economic Zones as an alternative to Six Pary Talks?* Masters Thesis, China Foreign Affairs University, 2013.

<sup>22</sup> The statistic excludes trade volume with South Korea.

<sup>23</sup> Gill, Bates. *China's North Korea Policy: Assessing Interests and Influences*. Washington: United States Institute of Peace, 2011.

coal-fired power plants, rail roads, oil refinery, and harbors.<sup>24</sup> China believes that through North Korean SEZs, it can gain two things. First is its primary goal of stability. An SEZ allows for more communication with North Korean officials, improving Chinese-DPRK relations on an economic and political level. Secondly, it is a way for China to help jump start its slowing GDP growth. In 2012, China's GDP grew at approximately 8%, 15% lower than its historical average of 10%.<sup>25</sup> Given that much of North Korea's natural resources, strategic location in the Sea of Japan, and large work force population have not been utilized to its full potential, China hopes to capitalize on the opportunity.

### **2.1 What is a special economic zone?**

In order to properly analyze the effects of multiple SEZs in North Korea, a basic understanding of how SEZs work is essential. The definition of a SEZ, or special economic zone is a "contained geographic region within a country that adopts liberal laws and economic policies to encourage invested manufacturing and services for export."<sup>26</sup> In layman's terms, it allows a relatively under-developed country to quickly open up isolated regions (rather than the entire country) which in theory increase foreign investments and tariff revenue, among many other things. Their prevalence around the world is not a coincidence, as they have become a part of the

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<sup>24</sup> Joonggang Daily. *China Backs North's Rason Project*. January 27, 2011.  
<http://koreajoongangdaily.joinsmsn.com/news/article/article.aspx?aid=2930656>.

<sup>25</sup> The date only includes GDP data from 1989 to 2012.

<sup>26</sup> Wang, Jin. "The Economic Impact of Special Economic Zones: Evidence from Chinese Municipalities." *Editorial Express*. September 2010. [https://editorialexpress.com/cgi-bin/conference/download.cgi?db\\_name=NASM2011&paper\\_id=239](https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=NASM2011&paper_id=239) (accessed November 2012).

overall economic development strategy for many nations. In 2008, there were approximately 3,000 SEZs in 135 countries that accounted for 68 million jobs and \$500 billion in trade.<sup>27</sup>

Considering the definition stated previously, any regional area that has laws encouraging foreign investment and trade can be considered an SEZ. Therefore, the term SEZ is really a blanket term that encompasses a plethora of different types of “zones” that vary throughout regions. For example, a type of SEZ is the EPZ, or the Export Processing Zone. The first Asian EPZ was established by the Indian government in 1965. Similar to the SEZ, an EPZ is an area where goods may be landed, handled, manufactured, and re-exported without the intervention of the customs authorities. The EPZ focuses on export business, manufacturing, and is more commonly used in developing countries. It is also synonymous with a Free Trade Zone (FTZ).<sup>28</sup> Although SEZs generally exist to promote trade through liberalized tax laws and reduced customs oversight, the unique nature of international trade has required SEZs to accommodate specific industries, working conditions, geography, and governments. Furthermore, the benefit of such zones depend on how well they are “integrated with their host economies,” thus in the case of North Korea, an SEZ must both be accepted by the government and people.

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<sup>27</sup> Ibid

<sup>28</sup> Amirahmadi, Hooshang, and Weiping Wu. "Export Processing Zones in Asia." Tufts University, February 2011.

Types of SEZ's		
Free Trade Zone (FTZ)	Geographically isolated, tax-free region providing storage, distribution, shipping, import/export operations. Labor intensive manufacturing that focuses on apparel, textiles, and electrical goods.	Colon Free Zone, Panama
Export Processing Zone (EPZ)	Similar to FTZs in terms of geography. However, there is more of a focus on exports but lack tax benefits. Provides a functional advantage to investors seeking to capitalize on economies of scale that a geographic concentration can bring to a trade region.	Lat Krabang Industrial Estate, Thailand
Enterprise Zones	Provide manufacturing benefits like FTZs and EPZs, but also focus on policies implemented by local governments to revitalize a distressed urban area. Can be located within a city or state.	The Empowerment Zone in Chicago
Single Factories	Has a focus on developing a particular type of industry. The manufacturer, or factory, can only receive the special trade incentives if they working in a specific industry. Factories are not limited by location.	Mexico's maquiladora system where factories around the country manufacture specific goods for export
Free Ports	Specializes in human capital goods and services, such as call centers and telecommunications. Very broad spectrum of services can be offered.	Songdo International Business District in South Korea
Specialized Zones	Regions that are dedicated to promoting highly technical products and services. Science and technology parks, off-shore financial service centers, and airport-based economies thrive here.	Dubai Internet City or the Purdue Research Park in Indiana

Figure 1: The University of Iowa Law School<sup>29</sup>

In addition to the EPZ, there are enterprise zones, single factories, free-ports, and specialized zones, as defined by Murray. Each type of SEZ has its own unique characteristics that appeal to a specific industry or region. For example, the “single factory” zone is not really a zone, but rather, a means for governments to focus on promoting a specific industry. In this case, only factories that produce a certain product get these incentives of, say, duty free exports or low interest loans. Despite the prevalence of SEZs around the world, North Korea’s situation is unique because of its historical development and Juche ideology, Kim Il-sung’s governing philosophy that focuses on defending the revolutionary spirit, self-reliance, and self-defense.<sup>30</sup>

<sup>29</sup> Murray, Megan. "What Are Special Economic Zones." February 9, 2010.  
<http://ebook.law.uiowa.edu/ebook/faqs/what-are-special-economic-zones> (accessed February 16, 2013).

<sup>30</sup> Lee, Grace. "The Political Philosophy of Juche." *The Stanford Journal of East Asian Affairs*, 2003: 105-115.

The application of Juche pushes for an isolationist policy that stresses independence from foreign countries.

Even though SEZs have been shown to help accelerate the growth of a nation's economy, it is not a panacea for all economic woes. In some instances, SEZs have been known to divert trade from domestic areas to the SEZ, thus actually decreasing the total exports of a country. As for national income, because taxes are more lax in SEZ areas, a country risks decreasing their national income with the hopes that other economic benefits can be made.<sup>31</sup> Furthermore, implementation of an SEZ can devastate local industries. Take for example the small fishing town of Shenzhen, China. Shenzhen grew at a rapid rate from 1980-84 with an annual growth of 58%. Money was flowing exponentially and due to the constant supply of cheap labor and drive for technological innovation, China benefitted as a whole from the economic gains of Shenzhen and its three SEZ region.<sup>32</sup> However, the region was formerly known for its strong fishing background and maintained a strong cultural presence throughout most of the 19<sup>th</sup> century. The town's sudden growth took away much of the culture and its local industry, forcing many fishermen and farmers to seek new employment.

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<sup>31</sup> Lankov, Andrei. *Special economic zones*. July 3, 2011.

[http://www.koreatimes.co.kr/www/news/nation/2012/09/304\\_90131.html](http://www.koreatimes.co.kr/www/news/nation/2012/09/304_90131.html) (accessed November 25, 2012).

<sup>32</sup> Yeung, Yue-man, Joanna Lee, and Gordon Kee. "China's Special Economic Zones at 30." n.d.

[http://www.espre.cn/111/manage/ziliao/China%26\\_039.pdf](http://www.espre.cn/111/manage/ziliao/China%26_039.pdf).

## **2.2 SEZs and North Korea**

“It is the unswerving will of the DPRK government and the Workers Party of Korea to carry on the legacy of the late leader Kim Jong-il.”

- Kim Jong-un, August 2012 <sup>33</sup>

Since his father’s death in 2011, Kim Jong-un’s priorities have been two-fold. First and foremost is the consolidation of power. This requires him to show his people that he, like his father, can continue to prove that North Korea is a “strong and prosperous nation.” In order to do this, he has funneled a significant portion of the North Korean budget into its defense department. In 2011, it was estimated that North Korea spent approximately \$5.1 billion, or 31% of its GDP, on military expenditures alone.<sup>34</sup> Secondly, his priorities are to maintain his father’s legacy by upholding the “long standing principles” set by the Workers Party of Korea in 1998 which means not becoming a “puppet country”<sup>35</sup> and resisting considerable foreign pressure from Beijing and Washington.

In order to continue his agenda, Kim Jong-un must be able to finance it. Thus, the function of special economic zones is to increase foreign investment and attract capital from abroad. An example of the revenue stream that could come from these zones is explained

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<sup>33</sup> Mansourov, Alexandre. *Kim Jong Un's Foreign Policy Record: The Juche Revolution Continues*. February 27, 2012. [http://38north.org/2013/02/amansourov020113/#\\_ftnref2](http://38north.org/2013/02/amansourov020113/#_ftnref2) (accessed February 27, 2012).

<sup>34</sup> Boik, William. *Undertanding the North Korea Problem: Why It Has Become The "Land of Lousy Options"*. The Letort Papers, Carlisle, PA: U.S. Army War College, 2011.

<sup>35</sup> A common name for South Korea by the North.



through an analysis of the Kaesong Industrial Complex.<sup>36</sup> Furthermore, Kim Jong-un is no fool. He, like his father, recognizes that North Korea needs to reform. Otherwise, Kim Jong-il would never have considered SEZs in the first place. Like China during its early opening up era, North Korea expects to use SEZs as a “testing ground for economic reform.” Time and time again, the effects of these reforms are minimized by the interference and control of the government which leaves many North Korea watchers with the belief that the regime has no true desire to reform, but rather, uses SEZs as a distraction for more ulterior motives.<sup>37</sup>

## **2.2 Past SEZs and the Sunshine Policy Era**

The history behind much of South Korea’s investment in North Korea comes from the Sunshine Policy established in 2000. The South Korean government believed that it was not possible for the Kim regime to continue on its current path, basing their belief on similar situations in Central Europe and South America. These aggressive regimes, such as the ones seen in Cuba, Libya, and Afghanistan, tended to fail as a result of their isolation and social unrest. Using the German unification as a case study, it was believed that in the event of a likely North Korean regime fail, it was necessary to stabilize the region beforehand. This would encourage a “soft landing” for North Korea’s society and protect South Korea’s economy. North Korea very likely recognized the ulterior motive of the Sunshine Policies. However, because the regime was in dire need of funds, they went along with the situation and on July 1, 2002, North Korea executed its “Reformation of Economic Management System,” also known as the 7/1

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<sup>36</sup> Refer to chapter regarding Kaesong Industrial Complex

<sup>37</sup> In many instances, the effects of SEZs in North Korea have been made impotent such as the forceful shutdown of the Mount Kumgang Tourist Region, cell phone/internet restrictions for North Korean officials in the Rason SEZ, and a botched 2009 currency reform (Abrahamian, A Convergence of Interest: Prospects for Rason Sepcial Economic Zone 2012).

Reformation. This policy was enacted to alter its socialist economy by experimenting with a “realistic model” that could address the new SEZs of Kaesong, Mt. Kumgang, and Sinuiju.<sup>38</sup>

Even though Kim Dae-Jung, President of South Korea during the Sunshine Policy era, is largely credited for the policy’s actual implementation, it was Korean Chaebol leader Chung Ju-Yung, founder of Hyundai, who was able to make it a success. Having been born in North Korea and also a “Korean Patriot,”<sup>39</sup> the idea of reunification was one of his core beliefs.<sup>40</sup> Upon hearing about a particularly harsh famine in the 1990’s, Chung illegally sought contact with DPRK leaders and offered assistance. In 1998, he successfully sent several hundred “unification cows” as relief, followed by millions of dollars in hard currency.<sup>41</sup> His actions helped open North Korea through the implementation of two zones, the Kaesong Industrial Complex and the Geumgangsan Tourist Area (Mount Kumgang Tourist Region or KTR).

#### **2.4 Mount Kumgang Tourist Region**

Mount Kumgang is historically known for its astounding beauty and mythical past. Beginning in 1998, the Hyundai Corporation had been running tour boats for South Koreans to visit the area. However, operating a tour boat industry into North Korea meant that the Hyundai Corporation had to take an estimated \$300 million loss after only three years. Following Chung

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<sup>38</sup> Koppen, Bernhard. *Special Economic Zones (SEZs) Along The Korean Demilitarised Zone: A Feasible Pathway Towards An Accessible North Korea*. Landau: University of Koblenz-Landau, 2010.

<sup>39</sup> The term “Korean Patriot” is used by Bernhard Koppen to define a Korean who believes in reunification and considers the idea as a core tenet of their Korean nationality.

<sup>40</sup> Ibid

<sup>41</sup> The public was not made aware of the estimated \$500 million that the South Korean government promised the North for helping them reestablish ties until the information leaked several years later. See Columbia University Law. “Hyundai’s \$500 Million Payments to North Korea: A Bribe or Business Deal.” February 9, 2003. [http://www2.law.columbia.edu/course\\_00S\\_L9436\\_001/2004/hyndais-money.pdf](http://www2.law.columbia.edu/course_00S_L9436_001/2004/hyndais-money.pdf) (accessed March 20, 2013).

Ju-yung's actions, North Korea permitted Hyundai to open a land route into Mount Kumgang as a way to improve the company's return on its investments.<sup>42</sup>

The Kumgang Tourist Region (KTR) was opened to South Koreans in 2002 and became a popular tourist attraction with over one million visitors by June 2005.<sup>43</sup> The KTR, although considered only partially successful thanks to the subsidies that Hyundai received from the South Korean government to run the region, became a symbol of improving Korean relations. Unfortunately, given the isolation of the area, there was little room for South Korean citizens to "mingle" with North Korean citizens, proving to be an ineffective platform for cultural reformation. A decade after its inception, it was estimated that over \$1.5 billion had been invested into the region by Hyundai.<sup>44</sup>

Ultimately, North Korea did not share the South's enthusiasm for cross cultural exchange and did two things to end the KTR. In 2006 they conducted their first nuclear test resulting in United Nations Security Council Sanction 1718 and 1695, both of which banned trade and froze North Korea's financial assets abroad.<sup>45</sup> At the same time, 40% of South Korean tourists also canceled their Mount Kumgang trip that year.<sup>46</sup> Secondly, in 2008 a North Korean border guard

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<sup>42</sup> New York Times. *North Korea seeks Chinese tourists for Mount Kumgang resort*. September 2011. <http://www.telegraph.co.uk/news/worldnews/asia/northkorea/8735312/North-Korea-seeks-Chinese-tourists-for-Mount-Kumgang-resort.html> (accessed March 29, 2013).

<sup>43</sup> Koppen, Bernhard. *Special Economic Zones (SEZs) Along The Korean Demilitarised Zone: A Feasible Pathway Towards An Accessible North Korea*. Landau: University of Koblenz-Landau, 2010.

<sup>44</sup> Kirk, Donald. *North Korea Takes over Mt. Kumgang*. May 16, 2011. <http://www.csmonitor.com/World/Asia-Pacific/2011/0516/North-Korea-takes-over-Mt.-Kumgang-tourist-area-further-dimming-Sunshine-legacy> (accessed March 31, 2013).

<sup>45</sup> United Nations. *United Nations Security Council SC/9679*. June 12, 2009. <http://www.un.org/News/Press/docs/2009/sc9679.doc.htm>.

<sup>46</sup> Kim, Yong-Hum. *Truth Revealed Behind Companies in Kaesung*. The Daily NK, 2007.

shot Park Wang-ja, a middle-aged South Korean tourist. The fatal shooting occurred at the same time as then South Korean president, Lee Myung-bak, resumed talks for additional aid to the North. When the North refused to further investigate the death of Park Wang-ja, the tourist area was indefinitely closed.

## **2.5 Sinuiju Special Administrative Region**



**Figure 2: Map of Sinuiju in proximity to China. Taken from Google Maps.**

Around the time that North Korea was developing its Mount Kumgang Tourist Region, talks were in progress for a special administrative region on the border of China and North Korea. The city of Shinuiju (Sinuiju) in North Korea, rests on the Yalu River and is connected to neighboring Dandong City via the Sino-Korea Friendship Bridge. It is also the home of the Sinuiju Special Administrative Region (SSAR). Under the “Sinuiju Basic Law,” the Sinuiju Special Administrative Region is a “special administrative unit under the sovereignty” and authority of the North Korean government but the SSAR has independent “legislative, executive,

and judicial powers at least for fifty years.”<sup>47</sup> Interestingly, it was Kim Jong-il who approached China’s then President, Jiang Zemin, about the project. Furthermore, Jong-il was supportive of the fact that the SSAR’s governing system was modeled after the Basic Law of the Hong Kong Special Administrative Region, implying that at the time, Kim Jong-il was indeed interested in economic reform. The region was intended to be a very secluded capitalist enclave using U.S. dollars as its currency. Furthermore, it was to have its own “legislature, courts, police force” and the ability to issue its own passports and gambling licenses.<sup>48</sup>

Believing that the zone had much potential, the Chinese and North Koreans began enthusiastically pursuing the joint venture. However, when Chinese-Dutch businessman Yang Bin was appointed Governor/Chief Executive of the region, no one expected the Chinese government to arrest and sentence him to eighteen years in prison. Prior to his appointment, Yang Bin was being investigated by the Chinese Securities Regulation Commission for tax evasion. However, his savvy entrepreneurial ability and relationship with Kim Jong-il made him the preferred candidate for the position. In 2003, Yang Bin was sentenced to eighteen years in prison and the Sinuiju Special Administrative Region’s development came to a halt.

Paul French, author of *North Korea the Paranoid Peninsula*, states that the Sinuiju Affair was ultimately a “highly confusing message” that can be interpreted in two ways. He writes that “either it was an act of desperation by Kim Jong-il to generate much-needed revenues for the country” or an honest attempt to “try out reform without risk.” Under the “Sinuiju Basic Law,” it

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<sup>47</sup> Lee, Eric Yong-Joong. "The Special Economic Zones and North Korean Economic Reformation with a Viewpoint of International Law." *Fordham International Law Journal*, 2003: Article 5.

<sup>48</sup> French, Paul. *North Korea: The Paranoid Peninsula: A Modern History*. London: Zed Books, 2005.

states that the region was essentially ceded by the government, but Pyongyang was still allowed military control. It is difficult to pinpoint Kim Jong-il's true motive for several reasons. First, there was no "real plan" behind the region, as it lacked a budget, pre-existing infrastructure, and an educated working population. To solve the workforce problem, the plan was to displace approximately 30,000 Sinuiju residents to the city outskirts and replace them with workers who were proven loyal to the regime and held a better knowledge of manufacturing. Secondly, Beijing, during its opening up era, utilized their SEZs as a way to mitigate the effects of radical change. They were able to anticipate their growing role in the global economy, World Trade Organization membership, and the discontent in their country. Deng Xiaoping, China's de facto leader until 1992, knew that in order for his country to succeed, it had to undergo significant change on both a cultural and economic level. Kim Jong-il at the time was not ready for such a change and showed it by severely limiting the amount of Western exposure North Korean workers could experience. An example being that most North Korean workers did not have access to email, a requirement for business operations in the 21<sup>st</sup> century. Furthermore, in some of the more developed areas, such as the new Rason SEZ, only one in five adults are expected to have access to a mobile phone.<sup>49</sup> However, this did not stop North Korea from implementing a more success venture with South Korea: The Kaesong Industrial Complex.

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<sup>49</sup> Abrahamian, Andray. "A Convergence of Interest: Prospects for Rason Sepcial Economic Zone." *Korea Economic Institute Academic Paper Series*, 2012.

## 2.2 The Kaesong Industrial Complex



**Figure 3: The Kaesong Industrial Complex, retrieved from Congressional Research Service**

Considering the difficulties Mount Kumgang Tourist Region and the Sinuiju Special Administrative Region had, one can only wonder if it is even possible to implement a successful SEZ in North Korea. In June of 2003, it was made possible when the Hyundai Asan and the Korea Land Corporation broke ground approximately 43 miles north of Seoul, across from the DMZ in North Korean territory. The Kaesong Industrial Complex (KIC) is a joint project between the ROK and the DPRK that, as of 2011, employs 47,000 North Korean workers, is home to 121 medium-sized South Korean companies, and produces over \$300 million in output.<sup>50</sup> The history of the KIC stems from as early as 1998, during the ROK's "Sunshine Policy" era. Led by the Hyundai Group, the plan was develop an industrial park where ROK businesses could utilize the cheaper North Korean labor for manufacturing purposes.

<sup>50</sup> Manyin, Mark, and Dick Nanto. *The KAesong North-South Korean Industrial Complex*. Report for Congress, Washington, D.C. : Congressional Research Service, 2011.

Alternatively, this venture had the potential to act as a “beachhead” for liberalization and economic reform.<sup>51</sup>

A crucial aspect for the KIC’s sustainability in North Korea is its financial benefit to North Korea. According to communication from the Office of Korean Affairs of the U.S. Department of State to the Congressional Research Service, the North Korean government collects an estimated \$2 million per month from worker fees, land lease fees, and other similar payments. Additionally, during the project’s initiation, the Hyundai Asan Company paid North Korea \$12 million for a 50-year lease on the entire Kaesong site. Overall, to the international community, the KIC is seen a successful venture and symbolic of the relationship between the two countries. Thus, several questions arise regarding the KIC. What makes it work and how can its success be applied to the development of Rason?

To address the first question; what makes the KIC work; it is important to recognize that the KIC is mutually beneficial to both parties. In the span of five years (between 2005 and 2010), the KIC produced approximately \$1.1 billion worth of goods and is home to over a hundred South Korean manufacturing firms.<sup>52</sup> It provides around \$2 million a month of constant revenue to the North Korean government and allows much cheaper labor for South Korean firms in comparison to those in China, Singapore, and other countries.<sup>53</sup> It is clear that the financial

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<sup>51</sup> The term “beachhead” is referring to the ROK’s hopes that reforms in the KIC will spill over to regions beyond the industrial complex and expose thousands of North Koreans to outside influence. See Congressional Research Service Report titled *The Kaesong North-South Korean Industrial Complex*.

<sup>52</sup> South Korean Ministry of Unification. *North Korea Economic Briefing*. Seoul: U.S. Embassy Seoul Economic Section, 2011.

<sup>53</sup> 2012 wages in the KIC were an estimated \$160 per month, in comparison to South Korea’s \$800 per month and China’s \$600 per month. See Roberts, Dexter. *North Korea, New Land of Opportunity*. January 19, 2012. <http://www.businessweek.com/magazine/north-korea-new-land-of-opportunity-01192012.html> (accessed March 31, 2013).



benefits to Pyongyang are quite substantial. According to the Hyundai Research Institute, North Korea could potentially receive “\$9.55 billion in economic gains over nine years” if the KIC progressed according to plan.<sup>54</sup> Figure 4 analyzes the effects of the KIC on the two Koreas and its surrounding region.

	Economic Effect	Political and Military Effect
South Korea	Restoration of small and medium enterprises in difficulties, providing motivation for new growth	Alleviation of military tension, expansion of policy options toward North Korea
North Korea	Solving economic difficulties, acceleration of economic reform, enlargement of economic openness	Change from military-centered policy, increase in political stability
South and North Korea	Increase in South-North Korean cooperation, co-prosperity and balanced development, establishing the base of an economic commonwealth	Mitigation of military tension in the Korean Peninsula, establishment of confidence in the military situation
Northeast Asia	Enlargement of economic cooperation in Northeast Asia	Increase of peace and cooperation in Northeast Asia

**Figure 4: Effects of SEZs in North Korea**<sup>55</sup>

From a South Korean perspective, the KIC represents both entry into the DPRK economy and a way to develop the North so that in the event of reunification, it would not shock both country's economies. Like Beijing's strategy during the return of Hong Kong in 1997, there were very different standards of living. By creating an SEZ near the border of Hong Kong, it prevented a large-scale immigration from China to Hong Kong due to Hong Kong's higher living

<sup>54</sup> Ibid, 12

<sup>55</sup> Lim, Kang-Taeg, and Sung-Hoom Lim . "Strategies for Development of a North Korean Special Economic Zone through Attracting Foreign Investment." *Studies Series by the Korea Institute for National Unification*, 2005.

standards. Using this strategy as a guide, South Korea is anticipating a regime failure. When that happens, the KIC's role will be to soften the landing.<sup>56</sup>

The KIC is also effective because it consists of only Koreans conducting business in the area. Of the 121 firms established there, not a single one of them is foreign. This allows for the same language, similar customs, and even similar cultural morals. As a result, even though the KIC is a foreign construct, it still has a sense of familiarity that appeals to the typically distrustful North Korean government and people. In 2010, during a period of strained tensions between the North and South, the KIC's future was twice thrown into doubt. The sinking of the Cheonan on March 26 resulted in the death of nearly fifty South Korean marines and forced President Lee Myung-bak to declare a halt to all forms of aid directed at North Korea.<sup>57</sup> After North Korean artillery units fired over one hundred shells at the Yeonpyeong Island, tensions became worse when four South Koreans were killed. The event almost led to the closing of the complex.<sup>58</sup> Regardless of tensions though, leaders from both countries were wary of shutting down the KIC for several reasons. In addition to providing \$2 million a month for the North, it would also result in thousands of unemployed citizens who would have to relocate their families. The unrest caused by such a large layoff would be dangerous to the regime, especially during a time when there has been international condemnation of its actions. Also, South Korea would have to pay hundreds of millions in insurance to the firms that use the park thus making its closure more costly than just temporarily suspending business.

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<sup>56</sup> Ibid, 15

<sup>57</sup> Office of the President of South Korea, "Special Address to the Nation by President Lee Myung-bak," May 24, 2010.

<sup>58</sup> Manyin, Mark, and Dick Nanto. *The KAesong North-South Korean Industrial Complex*. Report for Congress, Washington, D.C. : Congressional Research Service, 2011.

	End 2005	End 2006	End 2007	End 2008	End 2009	End 2010
No. of South Korean Manufacturing Firms	11	15	65	93	118 (Jan. 2010)	121
Approx. No. of North Korean Workers	6,000	11,000	23,000	39,000	42,000	47,000
Approx. No. of South Korean Workers	n.a.	700	800	1,500	960	Around 500
Annual Production Value	\$15 mil.	\$74 mil.	\$185 mil.	\$250 mil.	\$256 mil.	\$323 mil.
Exports to 3 <sup>rd</sup> Countries (i.e., not South Korea)	–	\$20 mil.	\$40 mil.	\$36 mil.	\$29 mil.	\$37 mil.

Figure 5: Kaesong statistics as of 2011<sup>59</sup>

It is important to establish that although the KIC is functioning well, it is still not a complete success. There are fears that the KIC “may never reach its potential or spur similar ventures, leaving it as a “vestigial reminder of a failed inter-Korean engagement.”<sup>60</sup> In the original plan set by the Hyundai Corporation, by 2012 there was supposed to be an estimated 1,500 South Korean firms and 350,000 DPRK workers.<sup>61</sup> Yet, based on the statistics provided by the South Korean Ministry of Unification, the region is far from staying on track with its original plan. As stated previously, in 2010 there were approximately 121 firms and 47,000 employees, both far below the estimated amount of 1,500 firms and 350,000 workers planned for phase three of the KIC.<sup>62</sup> For the SEZs achieve anywhere near the relative success that the KIC has, they must have strong support from China, policies that highly encourage investors (particularly from China), and protect the interests of the North Korean regime.

<sup>59</sup> Ibid, 1

<sup>60</sup> Cronin, Patrick. *Vital Venture: Economic Engagement of North Korea and the Kaesong Industrial Complex*. Washington, D.C. : Center for New American Security, 2012.

<sup>61</sup> See Figure 6

<sup>62</sup> See Figure 5

Year	Phase I (includes pilot) 2002-2007	Phase 2 2006-2009	Phase 3 2008-2012
Total Land at Completion of Stage	800 acres in Industrial Zone. Kaesong City as a Supporting Zone	2,000 acres in Industrial Zone 800 acres in Supporting Zone	4,800 acres in Industrial Zone 1,600 acres in Supporting Zone
Total ROK Firms at Completion of Stage	300	800	1,500
Total DPRK Workers at Completion of Stage	100,000	200,000	350,000

Figure 6: Original plan for the Kaesong Industrial Complex<sup>63</sup>

### 3.1 The Rason Special Economic Zone



Figure 7: Rason SEZ highlighted in red.

Despite the several unsuccessful SEZs implemented in the past, there are still plenty of incentives for North Korea to develop them because it would allow for experimentation with economic reforms in a manner that is “controllable, regional, and above all, containable.”<sup>64</sup> More importantly, they are a source of quick income from countries like China, South Korea,

and Russia.

In 2011, China and North Korea reinitiated plans in developing the Rason Special Economic Zone and establishing free trade regions on the Hwanggumpyong and Wihwado

<sup>63</sup> Ibid, 7

<sup>64</sup> Abrahamian, Andray. "A Convergence of Interest: Prospects for Rason Sepcial Economic Zone." *Korea Economic Institute Academic Paper Series*, 2012.

Islands. While Rason is located on the east-most end of the country, close to both Russia and China, the two islands are on the Western part of North Korea in the Yalu River. The islands are intended by Pyongyang to become the “Hong Kong of North Korea” and represent one of many steps taken towards developing the region.<sup>65</sup> However, given that they are still under construction as of 2012, there is not enough data on the two islands to give them a proper analysis. As for Rason, the keyword is **reinitiated**. Plans for an SEZ in North Korea began as early as 1991 when Rason was first established as the Rajin-Sonbong Special Economic Zone. To the rest of the world, this was progress towards a stable North Korea but there were major barriers to its success.

According to Andray Abrahamian, Pyongyang identified SEZs as a way to test economic reforms in a “manner that is controllable, regional, and above all else, containable.”<sup>66</sup> As stated previously, it is likely that North Korea sought to follow China’s lead, a country which at one point had living standards similar to those of North Korea. For the Chinese, SEZs were crucial to its development and allowed it to modernize in the span of two decades. Its success while maintaining strong a strong central government was an inspiration to many nations, prompting North Korea to seek similar measures. Pyongyang hoped to achieve similar success with its Rason SEZ, but there were several factors that prevented it from doing so.

First, North Korea is not China. Considering how successful the Shenzhen model was, China was able to replicate its success throughout the country with overall positive results.

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<sup>65</sup> Wit, Joel S. *38North.org*. February 19, 2012. <http://38north.org/2012/02/hgp021712/> (accessed February 5, 2013).

<sup>66</sup> Abrahamian, Andray. *A Convergence of Interests: Prospects for Rason Special Economic Zone*. Korean Economic Institute, 2012.

Because of China's large ethnic diaspora, almost 80% of investments in China came from Chinese people living overseas.<sup>67</sup> North Korea, unlike China, does not have a surplus of wealthy Korean nationals seeking to re-invest in their home country. Rather, overseas Koreans who did have opportunities to invest tended to be more attracted to South Korea. This economic competition between the North and South created several problems. If North Korea truly opened the Rason area and allowed major reforms, then many of North Korea's citizens working and living in that region would be exposed to the generous incentives given to investors, including tax refunds, removal of tariffs on manufacturing products, foreign currencies, and labor contracts. The premise of an SEZ, to increase foreign direct investments, makes an isolationist policy impossible because product, ideas, and international norms are bound to seep into the regions around it.<sup>68</sup>

Secondly, because of North Korea's dependence on Chinese trade, any development near its borders must be supported first by Beijing. Chinese priorities with North Korea revolve around maintaining a "harmonious" relationship that will not threaten the stability of East Asia. A failed North Korean state would mean hundreds of thousands of North Korean refugees flooding China's borders, a unified Korea, and the chance that nuclear weapons could be placed in the wrong hands. However, when it comes to economic policies, China has been known to be pragmatic, if not cutthroat. Should policies in Rason, Hwanggumpyong and Wihwado not give priority to Chinese firms, then China will likely pull its support because all China really needs is

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<sup>67</sup> Liu, Hong. "The Chinese Overseas: Homeland ties and agencies of interaction." 84. New York: Routledge, 2006.

<sup>68</sup> Abrahamian, Andray. *A Convergence of Interests: Prospects for Rason Special Economic Zone*. Korean Economic Institute, 2012.

North Korea to remain standing. In China's opinion, even if North Korea is impoverished, it is can still do its job as a buffer and stabilizer.<sup>69</sup>

The third issue is Pyongyang's priorities from 1991 to 2009. Nuclear development was the primary focus for North Korea. Despite recognizing the potential benefits of SEZ's, Pyongyang funneled the majority of its resources into its nuclear weapons program as a means to protect its regime. The fact that there was not even a paved road from China to the Rason port showed how little support the zone had.<sup>70</sup> Without any continued domestic investments into the Rason Special Economic Zone, one can expect a repeat of the 1991 failure. However, the new deal has spurred incentives such as visa-free access by Chinese citizens and the right to fifty-year land leases. Pyongyang's approvals of such policies are hopefully early signs of reform.<sup>71</sup>

Finally, North Korea has had significant problems with upholding contracts and showing positive return on investments. Da Zhigang, director of the Institute of Northeast Asian Studies at Heilongjiang Academy said that "any reasonable Chinese investor will think twice before putting money down."<sup>72</sup> An example of a failed investment is the Xiyang Group's business deal with North Korean contractors over a project to process iron ore. The Xiyang Group called their four-year long North Korean relationship a "nightmare" where the company lost \$55.3 million from

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<sup>69</sup> Bajoria, Jayshree. *The China-North Korea relationship*. October 7, 2010. <http://www.cfr.org/china/china-north-korea-relationship/p11097#p4>.

<sup>70</sup> North Korean Economy Watch. *Rajin-Wonjong Road Opened to Traffic*. October 26, 2012. <http://www.nkeconwatch.com/category/economic-reform/special-administrative-regions/rajinsonbong/>.

<sup>71</sup> Chance, David, and Christine Kim. *North Korea needs more reform to win China investment*. August 30, 2012. <http://in.reuters.com/article/2012/08/30/us-korea-north-economy-idINBRE87T05C20120830> (accessed 2012).

<sup>72</sup> Bandow, Doug. "The New North Korea: Prisons With Designer Hand-Cuffs." *Forbes*, November 26, 2012.

the venture when their North Korean partners failed to uphold contract obligations. The Xiyang Group is just one of dozens of Chinese companies that are allegedly being scammed by North Korea and represents one of the largest obstacles for an SEZ to be successful.

Previously, there was a lack of commitment from both parties as seen when neither country was able to take the initiative to pave a road between the Chinese border to Rason. If North Korea viewed the initial investments in Rason as a way to earn some quick cash, then the SEZ was doomed from the start. However, if North Korea truly intends to use the SEZ to modernize its economy, which there is substantial evidence that supports this claim, then the government must cooperate with China. The recent infrastructure advancements are important steps to creating a successful zone, most notably the Rajin-Wonjong Road that connects China and North Korea. Originally, the road was an unpaved, bumpy, and dusty path barely usable with even the sturdiest vehicles. Recently finished in October of 2012, its development marked the first major infrastructure change in the area as well as signs that this time; both parties are serious about their deal. The Chinese constructed road will be crucial in transporting goods between the two countries. Furthermore, although denied by the Chinese foreign Ministry, South Korean media outlet Yonhap News announced in February of 2012 that China “has secured the rights to build three new piers in a special economic zone in North Korea” in addition to “an airfield, thermal power plant, and a fifty-five kilometer railway track between Tumen and Rason.”<sup>73</sup> China’s commitment to the zone is further confirmed when the Korean International Travel Company (KITC) released a map detailing a small airfield which could potentially be the construction site of a Chinese funded airport.

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<sup>73</sup> Yonhap News Agency. *China secures right to use 3 piers to be built on N. Korean port for 50 years*. February 15, 2012. <http://english.yonhapnews.co.kr/northkorea/2012/02/15/88/0401000000AEN20120215007600315F.HTML>.



China's stake in the Rason Special Economic Zone is the "Changjitu" project – a plan to develop China's Changchun-Jilin-Tumen River area – through the ports available in Rason. The name of the project is shorthand for the region's name (**Changchu-Jilin-Tumen**) and its implementation was because China sought to invigorate the slow growing Jilin Province. The plan for the project is for the region to have an average economic growth of 19% per year and an economic output of over \$100 billion by 2020.<sup>74</sup> China's goal is to establish a logistical base in the region and eventually turn it into a transportation hub for the six nations in Northeast Asia (China, Japan, South Korea, Russia, North Korea, and Mongolia). Yeon Ho Lee and Jeong Shim Kang of Yonsei University sum up the Changjitu Project in a graph presented at the 2011 British International Studies Association.

Type	Main Contents
Meaning of the operation	China's first developmental plan for borderland areas where the Changchun-Jilin-Tumen River area are set as pilot zone for spearheading the open-door development in order to develop the Northeastern region especially Jilin Province. Regional cooperation in the Tumen River area is propelled in order to cultivate the Northeastern region.
Developing areas	The part of area of <u>Changchun</u> City, <u>Jilin</u> City, and the <u>Tumen</u> River area (AKA, the Yanbian Korean Autonomous Prefecture) in Jilin Province. Totaling 30,000 km <sup>2</sup> , with a population of 7.7 million (one-third of the total population in Jilin Province).
Developmental goal	1 <sup>st</sup> stage: Reach 728 billion yuan (\$111 billion) by 2012, about double the 2008 figure 364 billion yuan 2 <sup>nd</sup> stage: Reach 4 times the economy size by 2020 19% annual average growth required

Figure 8: Analysis of China's Changjitu Plan by Lee and Kang

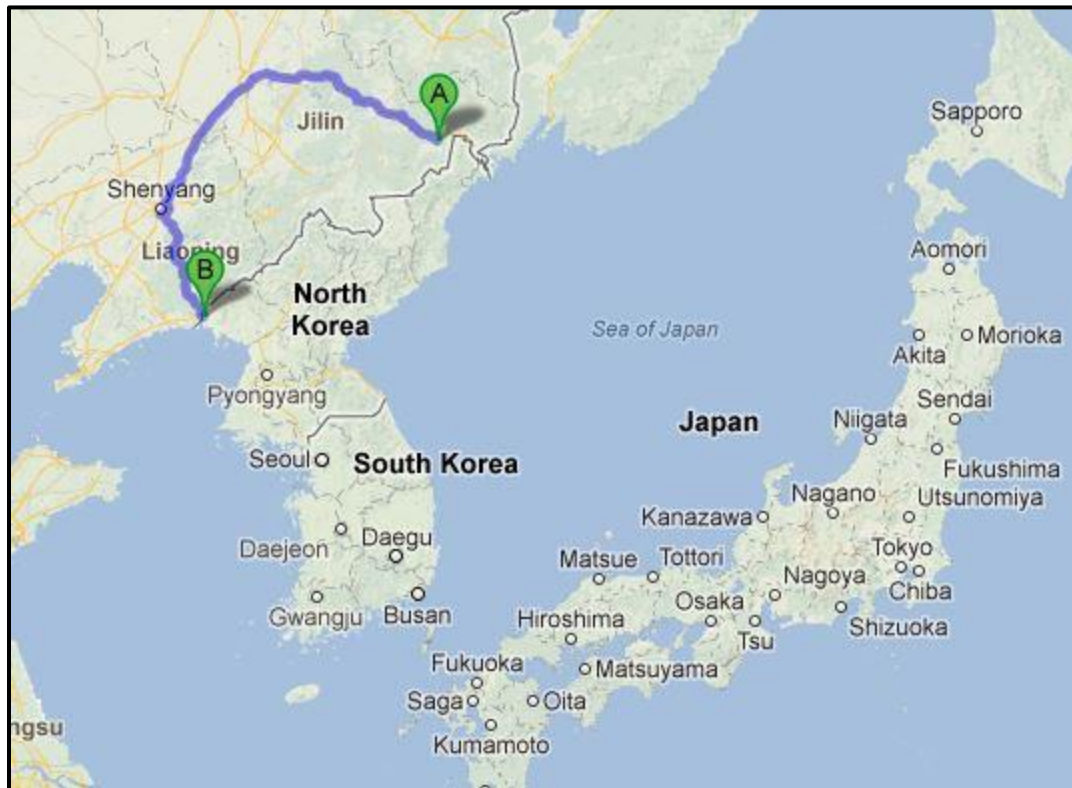
<sup>74</sup> Lee, Yeon, and Jeong Kang. "The Changjitu Project and China-North Korean Economic Cooperation." *BISA Annual Conference*, 2011.

Regional specialization within the pilot zone	<p><i>Hunchun</i>: window for open-door policy and international cooperation</p> <ul style="list-style-type: none"> <li>• Strengthening of trade function and easement of customs</li> <li>• Establishment of 3 sections: Borderland economy cooperation section, export process section, trade and commerce section</li> <li>ex) Northeastern Asia borderland trade center</li> <li>• Bilateral and multilateral economic cooperation section</li> <li>- Industrial complex by North Korea, China, Russia, South Korea, and Japan</li> <li>ex) Hunchun special economic cooperation section</li> <li>• Establishment of free-trade area in the Tumen River area</li> </ul>
	<p><i>Yan-Long-Tu</i>: Central city in eastern region, center for process trade, and development of technology &amp; service industries</p> <ul style="list-style-type: none"> <li>• Establishment of a central city in the eastern part of Jilin Province through a unification of 3 small towns, Yanji-Longjing-Tumen, put it under administrative care</li> <li>• Cultivation of the modern service industries: massing of producing elements, high-level process-produce businesses, technology industries, logistics, tourism, culture, business, finance and Insurance</li> <li>ex) central region for taking over the Yanbian processing trade</li> <li>• Development section for nation-level technology industries</li> </ul>
	<p><i>Changchun-Jilin</i>: Innovative section for scientific technology, Developmental base for cutting-edge technology industries</p> <ul style="list-style-type: none"> <li>• Changchun cutting-edge technology section, Changchun core section for Northeastern areas, Core section for Jilin Northern industries</li> <li>- Establishment of 8 major new industry bases (Automobile, Petro chemistry, Photoelectron data, Metallurgy/Construction materials, Equipment production, Bio, New material), Jilin Province cluster section for cutting-edge/high-end industries, Nation-level self-innovation testing section, Cooperative section of Northeastern Asia for cutting-edge technologies</li> </ul>

Figure 8: (Continued)

The benefits of having a port at Rason include a significant logistical advantage regarding trade through the Sea of Japan. In China's Northeast city of Hunchun, it is estimated that there is 1.2 billion tons of coal in addition to a plethora of raw materials like crude oil, natural gas, and forestry products. In the past, those natural materials were mined and transported south to the city of Dandong (Figure 8 point B), where they were then shipped through trade routes in the

Yellow Sea to Japan. Currently, this process takes an average of twelve days. With access to a Rason port, companies could ship their goods and have them reach their destination in the span of a day.



**Figure 9:** Drawn by author using Google Maps

For North Korea, Rason is crucial for its economic strategy of using SEZs to implement minor reforms. Unlike the KIC, which focuses primarily on manufacturing of South Korean goods, the Rason SEZ will allow North Korea to profit from the amount of trade occurring in the area. China and Russia have permission to use the Rajin harbor and hold exclusive contracts to the piers. Furthermore, they have also been given permission to build three more piers and the rights to use them for next fifty years. These contracts are worth millions of dollars when you consider the additional revenue that will come from port fees, tolls, and tourism. In their paper titled *The Chanjitu Project and China-North Korea Economic Cooperation*, Lee and Kang state

that the development of Rason is a “top priority” for the DPRK regime for several reasons. First and foremost, it will soften the effects of the four United Nations Security Council sanctions currently in place to weaken the Kim regime. Secondly, it will allow more leverage in international negotiations such as Six Party Talks because major investments made by China and Russia will be at risk. Finally, it can give North Korea the opportunity to experience Chinese style growth and new economic policies.

#### **4. Conclusion: SEZ as a Means for Reform**

There is strong historical evidence supporting the claim that special economic zones are an effective method for implementing reform, but North Korea could be the exception. Two things are very clear about North Korea. First, the regime needs money and the quickest way to get it is from countries like China and South Korea. Secondly, although SEZs would create a dependency on international trade, the North Korean government is willing to risk that for more political leverage against China and South Korea. In April of 2013 North Korea simply “closed” the KIC, putting billions of South Korean investments at risk. It is becoming more and more clear that the regime is willing to sacrifice economic power for political. The Hyundai Research Institute conducted a study in 2004 that estimated North Korea’s economic benefit from the KIC could be up to \$9.55 billion over the course of nine years<sup>75</sup> and North Korea appears willing to sacrifice such gains. In 2011 alone, North Korea exported only \$4.707 billion worth of goods and imported an estimated \$4 billion. Therefore, the potential benefits of the KIC could possibly double North Korean exports and imports. However, the KIC has fallen behind in its strategic plan and is far from its estimated potential. If allowed to reach its potential though, South Korea

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<sup>75</sup> Lim, Eul-chul. *Kaesong Industrial Complex, History, Pending Issues, and Outlook*. Seoul: Haenam Publishing, 2006.

will rely even more heavily on North Korea keeping the region open which in turn gives North Korea more political leverage.

The problem is that every attempt at creating a successful SEZ in North Korea has resulted in failure, postponement, or stagnation. In the case of the Sinuiju Special Administrative Region, the appointed governor was arrested by the Chinese government and both governments are unwilling to reinitiate talks. The Mount Kumgang Tourist Region showed much promise and for several years maintained a constant flow of South Korean tourists. However, North Korea still will not open an investigation of Park Wang-ja, the South Korean tourist that was shot by North Korean guards. In addition to her death, the region was also operating at a loss for the Hyundai Asan Corporation. There is little hope that the mountain will be opened anytime soon. The most successful SEZ is by far the Kaesong Industrial Complex, but as stated previously, the SEZ is far behind its proposed development plan.

The last chance for a successful SEZ in North Korea is the Rason Special Economic Zone and its cooperation with the Changjitu Plan. Rason is different from Sinuiju for several reasons. First and foremost, it is housed in a very geostrategic location between Japan, Russia, and China. A port there would cut the time it would take for China to ship goods to Japan from twelve days to one. Sinuiju on the other hand is confined to the Yellow Sea and, if a SEZ were to be successfully implemented there, it would not benefit the Liaoning province nearly as much as Rason would benefit the Jilin province. Secondly, the final plan for Rason, as explained by Lee and Kang, is for China to turn it into a transportation hub for six nations (Japan, South Korea, Russia, North Korea, and Mongolia). China has already obtained contracts, several of them lasting up to fifty years, for exclusive access to specific piers. In October of 2012 China completed a modern day road connecting Rason's two cities to China. For over two decades the

road symbolized the previous lack of commitment between the two countries. Now, it is a sign that both nations are ready for change.

There is much more evidence supporting the idea that Rason will be a more successful SEZ than the previous ones. With China so willing to invest billions into the region, it could potentially be a very large cash cow for Kim Jong-un and his regime. The most difficult part of the Rason SEZ will be to attract investors. In 2013 alone, North Korea severed the direct military “hot line” to South Korea, re-declared war on South Korea, threatened a pre-emptive strike on the United States, and restarted its primary nuclear reactor.<sup>76</sup> From an investor’s perspective, North Korea is a risk not worth taking. Even the Chinese leadership recognizes the risks of intervening in such an unstable region and it would be their own doing if the Rason SEZ should fail. Ultimately, SEZs cannot be considered as a means for reform until Kim Jong-un is willing to accept cultural change in his country. Furthermore, SEZs will be just as ineffective as Six Party Talks for that same reason.

The last thing North Korea needs is another war. It barely survived the first Korean War and now, almost completely isolated from the world, it will most definitely not survive another. If Kim Jong-un truly intends to make his country sustainable, he must begin to accept SEZs as a means for reform. Otherwise, like the recent events with the Arab Spring, the Korean peninsula may experience its own awakening.

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<sup>76</sup> Taylor, Guy. *US Warns NKorea on Reckless Provocations*. April 3, 2013.  
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